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**SOUTH CAROLINA DEPARTMENT OF REVENUE TAX PROCESSES:
OUTSOURCE OR CONTINUE IN-HOUSE PROCESSING**

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For Certified Public Management Program**

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STATE DOCUMENTS

Introduction

The mission of the South Carolina Department of Revenue (DOR) is to “administer the revenue and regulatory laws of this state in a manner deserving the highest degree of public confidence in our integrity, effectiveness and fairness. To accomplish its mission, DOR will continuously evaluate and implement innovative technology to improve the quality and speed of service delivery while minimizing cost.”⁵ Since 1994, DOR has seen a dramatic increase in its technological initiatives by allowing returns to be electronically filed. Currently, forty percent of the returns filed are electronic returns and DOR has been ranked at the top in the nation for electronic filed returns. However, paper returns continue to require a large temporary staff and demand significant full time resources for seven months, December through June, of the filing season. With limited State funding, DOR continues to explore alternatives to processing paper documents. There is a critical need to review our current paper return requirements, processes, and costs to process income, fiduciary and partnership returns (hereafter referred to as “Tax Process”). We should and compare the total costs of the current process to the cost of outsourcing the Tax Process. Tax Process is defined as all activities and resources to process the income, partnership and fiduciary returns from picking up the mail from the post office until it is stored in the file room. Tax Process also includes the cost to process application for temporary employees. These temporary personnel infusion during the processing season impacts the entire agency. The Tax Process will be examined to determine its costs and compare that cost to outsourcing the processes.

Collection of activity and financial information

To determine the cost of the Tax Process and outsource options, financial and activity information were gathered from Application Processing, Mail Center, Revenue Processing, Income Tax Processing, Data Entry, Data Control and Central Records.

Application Processing – The activity of collecting employment application, checking for income tax filing and doing criminal background check.

Mail Center – The activity of picking up the mail, opening and sorting the mail and delivering the mail to the various sections.

Revenue Processing – The activity of assigning file number to the returns and payments, batching documents for Data Entry.

Income Tax Processing – The activity of reviewing the income tax return, verifying credits and payments.

Data Entry – The activity of keying and verifying tax data, and transmitting information to the mainframe computer system.

Data Control – The activity of separating checks and documents, endorsing checks and depositing funds into the bank.

Central Records – The activity of picking up the tax records from Data Control and storing the paper documents.

To collect the financial information, the following steps were taken:

Interview Section Supervisors - Interviews of supervisors were conducted to determine current staffing, man hours to complete work, work flow, potential costs and documentation of processes. Exhibit #2 is a copy of the interview questions.

Develop a general flow chart -During the fiscal year 1999 – 2000, Price, Waterhouse, Cooper had conducted a study of DOR's tax processing systems. A product of that study was a detail process analysis that outlines the flow of work. The analysis was compare to the interviews I conducted. Adjustments were made to reflect changes in DOR processes. A general Tax Process flow chart was developed. Exhibit #1 is the general flow chart developed.

Collection of the agency's financial data for fiscal year 2002 – 2003 - In 2002, DOR conducted a budget review. Under the direction of the agency's Administrator for Financial Management, John Taylor, CPA, a Zero Base Budgeting (ZBB) process had started. All expenditures were identified by divisions. Detail financial information within each division, by sections, was available. I utilized the EXCEL database to collect all the financial information for the Mail Center, Income Tax Processing, Revenue Processing, Data Entry, Data Control and Central Record sections. Tables 1, 2, 3, 4 and 5 tables represent the costs for fiscal year 2002 – 2003.

Collection of an outsource vendor cost information - "Outsourcing is defined as contracting with a private-sector firm to take responsibility for a function or process for which the government remains accountable."⁴ Cost information for an outside vendor was obtained from a bid contract for personnel services. All the DOR positions associated with Tax Process were identified along with hourly pay rate for each job. The hourly pay rate includes State benefits package. These DOR positions were compared to similar job in the bid for personnel services. Chart 1 has the comparison of DOR employee cost compared to similar position with an outsource vendor. The outsource vendor rate has a 40% markup.

Data analysis and interpretation

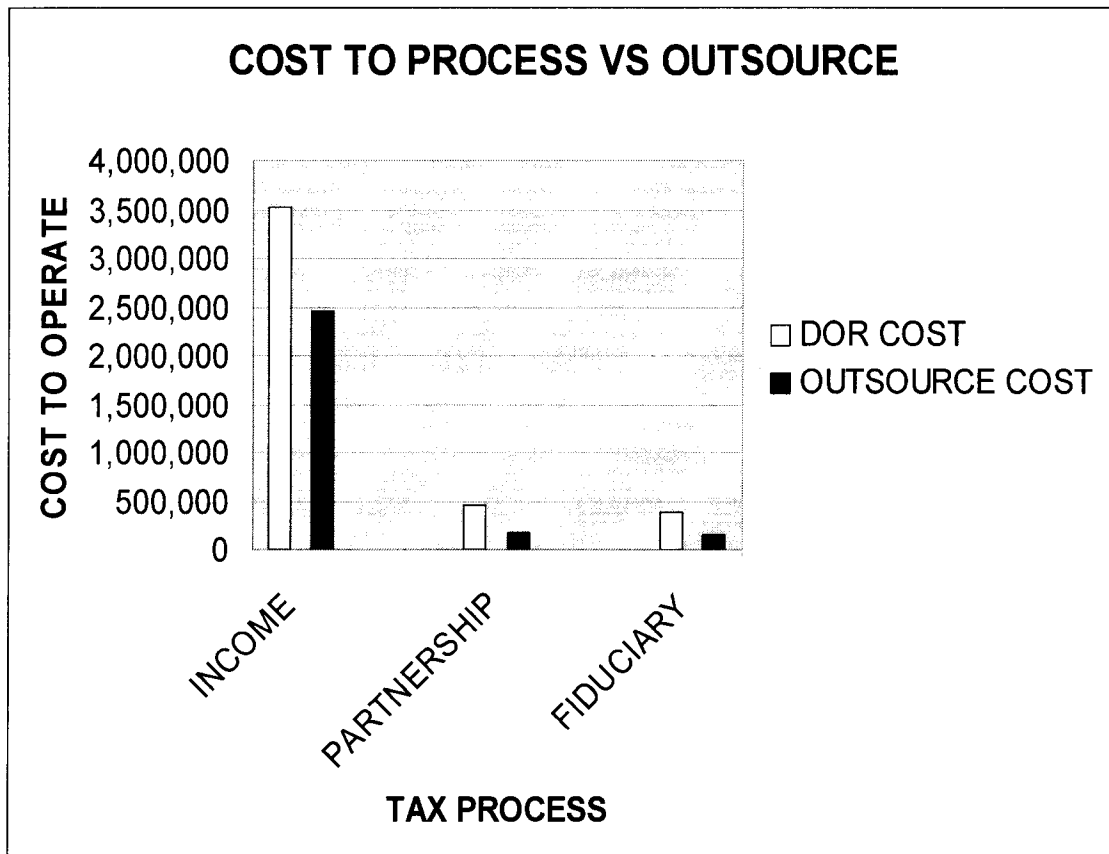
The process to compile the data in Tables 1 through 5 required several assumptions. The following assumptions were made:

- The process to be considered for outsourcing is the paper process. The electronic process is not a part of the analysis.
- It takes 7 months to process the income tax returns.
- It takes 1 month to process the partnership and fiduciary returns.
- A work day is composed of 7.50 hours.
- It takes 2 minutes per staff person to do an income and criminal background checks.
- The PC, Software, computer mainframe and space costs provided in the DOR's ZZB EXCEL spread sheets represent yearly costs.
- DOR will provide the work space, supplies, PCs, software, computer mainframe to process returns.
- DOR will do all income and criminal background checks.
- Training will be done by DOR staff.

Table 1 has been summarized in the chart on page 6. Clearly, the cost to outsource is less than the current cost DOR is incurring to process the income, partnership and fiduciary returns. To outsource the Tax Process would save the following amounts:

Income Process	\$ 1,080,387
Partnership Process	\$ 268,268
Fiduciary Process	\$ 237,014
Total savings	\$ 1,585,669

The greatest savings would be in the income tax process. However, a closer review of the notes from the supervisor's interviews identifies one area that is difficult to determine the total cost – knowledge. One reason for the gap in DOR and the outsource vendor costs can be attributable to training cost. The DOR man hours required to train, the training manuals and supplies and the knowledge level of the outsource vendor's staff are factors that would consume a significant portion of the savings. An estimated 95 full time employees plus some 100 day and night seasonal temporary employees would require training if the complete Tax Process would be outsourced. Before any decision is made to move forward, considerable cost analysis would need to be made on the training issue.



Implementation and Evaluation

To implement an outsource operation, the following “best practices” have been followed:
3, 2, 1

- Transition / Implementation Teams
- Stakeholder buy-in
- Balanced score card
- Partnership charter. Focus on teamwork or partnership approach. ¹
- Innovation
- Incentives for the outsource vendor. Develop a performance based pricing structure. ²

Recommendations

Outsource the process over an eight year period.

Year 1	Partnership agreements developed with Outsource vendor to document the processes for all sections. Each section should work with vendor to outline a step-by-step operational manual.
Year 2 and 3	Outsource the Mail Center, partnership and fiduciary returns.
Year 4	Outsource the Revenue Processing activities.
Year 5	Outsource Income Tax Processing
Year 6	Outsource Data Entry
Year 7	Outsource Data Control
Year 8	Outsource Central Records

Develop and conduct an evaluation

An annual evaluation of vendor’s performance should be made. Develop a scoring card, a list of expectations with success criteria, in year one that will objectively determine performance. Identify success criteria for each performance requirements.

Incentives

Provide monetary incentives for good performance and penalties for substandard and unacceptable performance. The vendor should participate in the development of the incentives. For example, high attendance rate – at least 95% attendance rate;. applicants free of criminal charges and file tax returns; vendor pays for unsuccessful background checks.

Obstacles and methods to overcome them

There are challenges that will need to be addressed with DOR and the outsource vendor that impacts performance and productivity. Issues include:

- Lack of motivation and commitment of vendor employees
- Absenteeism
- Income tax clearance and criminal background checks
- Limited tax knowledge. Cost and time for annual training will be an unknown.

Participation of current DOR staff

Form teams to assist in the development of outsourcing Provide timely information to employees so the objective of outsourcing is kept in focus. Minimize the fear of job loss.

Conclusions

DOR has an opportunity to reduce its processing cost through outsourcing. Careful planning and employee involvement are the keys to the success of outsourcing. As the TERI employees approach their departure time, we can maximize our efforts by documenting all of our processes. Development of a knowledge management database from our experienced staff is essential. As State funding continues to decrease, outsourcing will become more of an investment rather than an option.

TABLES

CHARTS

EXHIBITS

EXHIBIT 1

TAX PROCESSING FLOW Chart

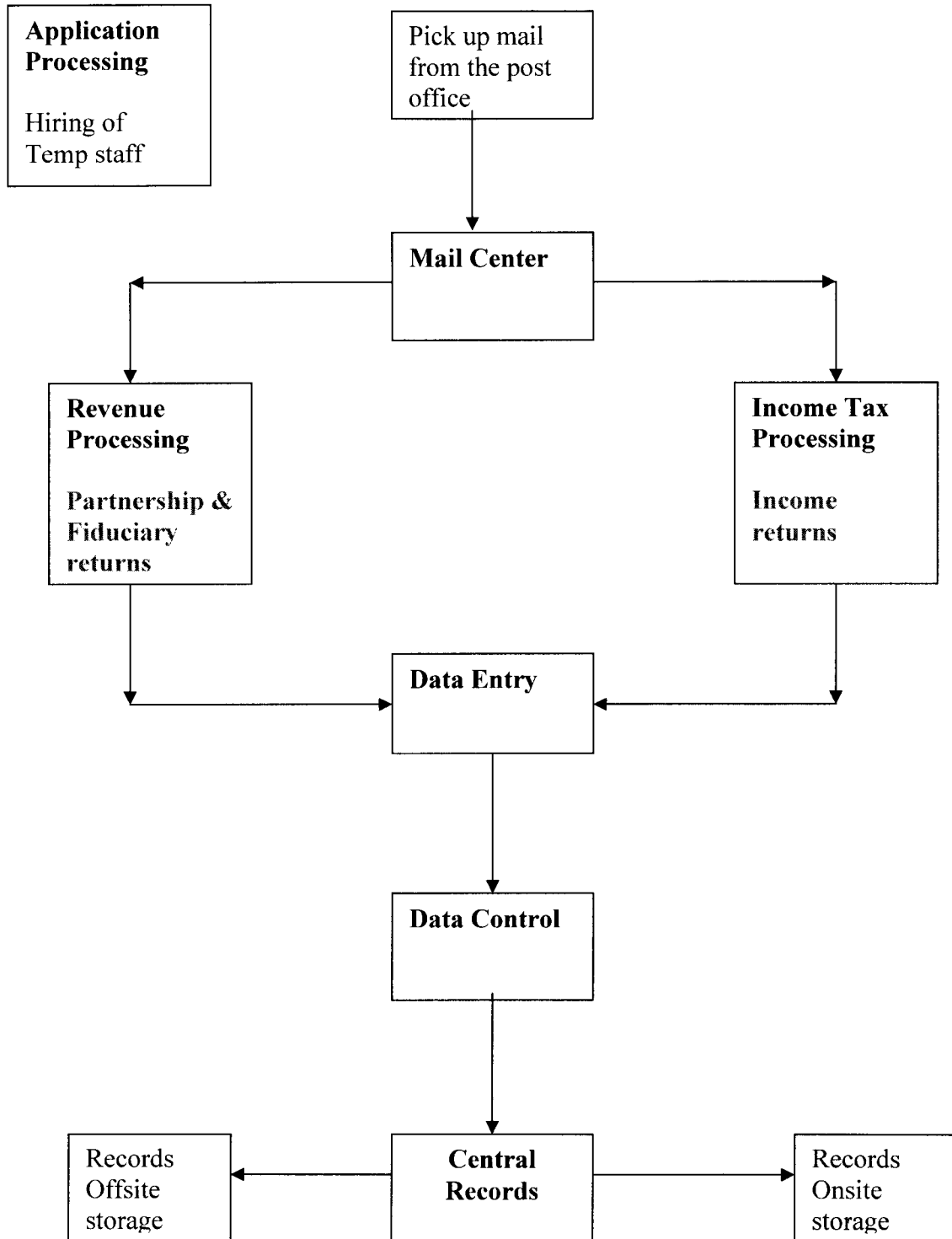


EXHIBIT 2

INTERVIEW QUESTIONS

Management Employee

Staff employee

NAME _____

DATE _____

Purpose of the interview

Define the process

Determine what information is available about the income, partnership and fiduciary processes.

Determine if any outsource work has been done.

Identify all costs associated with the current processes of income, partnership and fiduciary returns.

1. What are some possible causes for the processing delays with income, partnership and fiduciary tax returns?
Income Partnership Fiduciary
2. What are some possible solutions?
3. Are you aware of any work that has been done on the outsourcing issue?
Who? When? Where?
4. Are you aware of any state that has outsourced their process? Who?
5. To your knowledge, who works with the income, partnership or fiduciary tax returns? How much time is spent processing returns? How much time is spent on each return?
Income Partnership Fiduciary
6. As you know it, describe the process from the Mail Center to the Records Section.
For Income tax return
For Fiduciary tax return
For Partnership tax return
7. Are processes documented? Flow chart?

CHART 1

COST OF LABOR FOR DOR AND OUTSOURCE VENDOR

DOR rate per hour	DOR Positions	Outsource positions	Outsource rate per hour
\$ 31	Administrative Assistant	Staff Assistant	\$ 10.85
\$ 37	Data Control Supervisor	Senior Accounting Clerk	\$ 16.10
\$ 34	Data Coordinator B	Senior Accounting Clerk	\$ 16.10
\$ 38	Data Entry Supervisor B	Senior Accounting Clerk	\$ 16.10
\$ 40	Data Processing Supervisor	Senior Accounting Clerk	\$ 16.10
\$ 23	Data Technician A	Data Entry Operator I	\$ 10.50
\$ 27	Data Technician B	Data Entry Operator I	\$ 10.50
\$ 36	Tax Examiner D	Senior Accounting Clerk	\$ 16.10
\$ 31	Income Tax Processing Supervisor	Senior Accounting Clerk	\$ 16.10
\$ 32	Mail Processing Supervisor		\$ 16.10
\$ 26	Postal Clerk A	Casual Labor – Heavy	\$ 10.15
\$ 28	Postal Clerk B	Casual Labor – Heavy	\$ 10.15
\$ 32	Processing Coordinator	Senior Accounting Clerk	\$ 16.10
\$ 23	Processing Technician A	Accounting Clerk II	\$ 10.85
\$ 27	Processing Technician B	Accounting Clerk II	\$ 10.85
\$ 28	Processing Technician C	Accounting Clerk II	\$ 10.85
\$ 32	Records Coordinator	Senior Accounting Clerk	\$ 16.10
\$ 23	Records Section	Records Management	\$ 10.85
\$ 26	Records Technician A	Records Management	\$ 10.85
\$ 29	Records Technician B	Records Management	\$ 10.85
\$ 29	Registration Tech	Secretary II	\$ 10.30
\$ 34	Revenue Processing Supervisor	Senior Accounting Clerk	\$ 16.10
\$ 29	Secretarial Technician B	Secretary II	\$ 13.30
\$ 29	Temporary employee	General File Clerk	\$ 10.15

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1. Outsourcing Journal, June 2003, "Outsourcing-Optimal Outsourcing-When Both Parties Are Reading from the Same Play Book" page 4.
2. Outsourcing Journal, June 2003, "Outsourcing-Optimal Outsourcing-When Both Parties Are Reading from the Same Play Book" page 4.
3. "Impact of Best Practices in Outsourcing Arrangement" by Kathleen Goosy, 2003.
4. "Outsourcing in Government: Pathways to Value", page 1, by Accentor, May 2003.
5. South Carolina Department of Revenue Strategic Plan

TABLE 5
PARTNERSHIP RETURN PROCESSING
FISCAL YEAR 2003 - 2003

	OUTSOURCE COST	Man Hours	Mail Center	Revenue Processing	Data Entry	Data Control	License & Registration	Central Records
<i>Activity Allocation</i>								
Mail Center								
Postal Clerk A (2)	\$ 3,350	330	\$ 6,580					
Postal Clerk B	\$ 1,875	185	\$ 4,520					
Travel cost	\$ 210		\$ 210					
PC cost	\$ 77		\$ 77					
Software cost	\$ 184		\$ 184					
Mainframe cost	\$ 261		\$ 261					
Space cost	\$ 247		\$ 247					
Personnel - Mail Processing Tech (11 FTEs)	\$ 1,790	185	\$ 62,855					
Personnel - 7 / 80 hr employees	\$ 1,790	185	\$ 32,495					
Mail Processing Supervisor	\$ 1,790	185	\$ 5,290					
Space allocation	\$ 412		\$ 412					
Revenue Processing								
Personnel - FTE - Revenue Processing Supervisor	\$ 2,657	185	\$ 5,610					
PC cost	\$ 77		\$ 77					
Software cost	\$ 122		\$ 122					
Mainframe cost	\$ 391		\$ 391					
Space cost	\$ 412		\$ 412					
Personnel - Processing Coordinator	\$ 2,657	165	\$ 5,280					
PC cost	\$ 77		\$ 77					
Software Cost	\$ 122		\$ 122					
Mainframe cost	\$ 261		\$ 261					
Space cost	\$ 412		\$ 412					
Personnel - Processing Tech A (3 FTEs)	\$ 5,371	485	\$ 11,365					
PC cost	\$ 231		\$ 231					
Software cost	\$ 366		\$ 366					
Mainframe cost	\$ 391		\$ 391					
Space cost	\$ 741		\$ 741					
Personnel - Processing Tech B (2 FTEs)	\$ 3,551	330	\$ 8,910					
PC cost	\$ 153		\$ 153					
Software cost	\$ 367		\$ 367					
Mainframe cost	\$ 783		\$ 783					
Space cost	\$ 494		\$ 494					
Personnel - Processing Tech C (5 FTEs)	\$ 8,951	825	\$ 23,109					
PC cost	\$ 383		\$ 383					
Software cost	\$ 612		\$ 612					
Mainframe cost	\$ 1,957		\$ 1,957					
Space cost	\$ 1,235		\$ 1,235					
Data Entry - Key Punch								
Personnel - Data Processing Supervisor	\$ 2,673	185	\$ 6,660					
Personnel - Data Entry Supervisor B	\$ 2,673	165	\$ 4,270					
Personnel - Data Entry Supervisor B	\$ 2,673	165	\$ 5,270					
PC cost (3)	\$ 231		\$ 231					
Software Cost (3)	\$ 551		\$ 551					
Mainframe cost (3)	\$ 862		\$ 862					
Space cost (3)	\$ 1,235		\$ 1,235					
Personnel - Data Technician - A (13)	\$ 22,529	2145	\$ 49,335					
Personnel - Data Technician B (10)	\$ 17,325	1650	\$ 44,850					
PC cost (23)	\$ 1,761		\$ 1,761					
Software cost (23)	\$ 4,223		\$ 4,223					
Mainframe cost (23)	\$ 3,001		\$ 3,001					
Space cost (23)	\$ 6,661		\$ 6,661					
Data Control								
Personnel - Data Control Supervisor	\$ 2,657	185			\$ 6,106			
PC cost	\$ 77				\$ 77			
Software cost	\$ 122				\$ 122			
Mainframe cost	\$ 391				\$ 391			
Space cost	\$ 412				\$ 412			
Personnel - Data Coordinator B	\$ 2,657	165			\$ 5,810			
PC cost	\$ 77				\$ 77			
Software cost	\$ 122				\$ 122			
Mainframe cost	\$ 391				\$ 391			
Space cost	\$ 247				\$ 247			
Personnel - Processing Tech A (5)	\$ 8,951	825			\$ 19,978			
PC cost	\$ 385				\$ 385			
Software cost	\$ 612				\$ 612			
Mainframe cost	\$ 1,952				\$ 1,952			
Space cost	\$ 1,235				\$ 1,235			
Personnel - Processing Tech B (2)	\$ 3,581	330			\$ 8,910			
PC Cost	\$ 153				\$ 153			
Software cost	\$ 367				\$ 367			
Mainframe cost	\$ 783				\$ 783			
Space cost	\$ 494				\$ 494			
Personnel Processing Tech C (1)	\$ 1,790	165			\$ 4,620			
PC cost	\$ 77				\$ 77			
Software cost	\$ 122				\$ 122			
Mainframe cost	\$ 391				\$ 391			
Space allocation	\$ 247				\$ 247			
Licensing & Registration								
Personnel - Revenue Supervisor	\$ 2,657	185				\$ 7,425		
PC cost	\$ 77					\$ 77		
Software cost	\$ 122					\$ 122		
Mainframe cost	\$ 391					\$ 391		
Space allocation	\$ 436					\$ 436		
Personnel - Registration Tech (10)	\$ 16,995	1650				\$ 47,850		
PC cost	\$ 766					\$ 766		
Software cost	\$ 1,636					\$ 1,636		
Mainframe cost	\$ 3,214					\$ 3,214		
Space allocation	\$ 2,470					\$ 2,470		
Central Records								
Personnel - Records Coordinator	\$ 2,657	185					\$ 5,290	
Personnel - Records Specialist (2)	\$ 3,581	330					\$ 7,590	
Personnel - Records Tech A (2)	\$ 3,581	330					\$ 8,580	
Personnel - Records Tech B (2)	\$ 3,581	330					\$ 9,570	
Storage - On site	\$ 2,322						\$ 2,322	
Storage - Offsite	\$ 530						\$ 530	
TOTAL	\$ 183,051	11,880	\$ 106,001	\$ 63,872	\$ 130,690	\$ 61,577	\$ 66,287	\$ 33,872 \$ 451,296